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No. 06-1236

In the
Supreme Court of the United States

LANCO, INC.,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

ARGUMENT

I. CERTIORARI IS NOT WARRANTED BECAUSE THE STATES ARE IN ACCORD ON THE QUESTION OF WHETHER THE COMMERCE CLAUSE PERMITS THE ASSESSMENT OF INCOME TAX ON REVENUE GENERATED BY A CORPORATE TAXPAYER FROM THE USE OF INTANGIBLE PROPERTY IN THE STATE, BUT TRANSFERRED THROUGH A TAX AVOIDANCE MECHANISM TO A RELATED COMPANY IN A STATE THAT SHELTERS THAT INCOME FROM TAXATION.

Petitioner seeks to draw this Court into a field where judicial precedent has firmly developed in a uniform fashion and where State legislative action has largely eliminated the continuing validity of the tax avoidance mechanism -- the intangible property holding company (IHC) – that is the subject of this appeal. Intervention by this Court is not warranted because the *per curiam* decision below is in accord with the decisions of other State courts that have addressed the issue and conforms with legislative developments in a vast majority of States, including New Jersey, that eliminate the ability of related entities to escape taxation through the use of an IHC.

An IHC is a corporate entity created by a parent or operating company to hold intangible assets, usually the trademarks, service marks, and good will of a related company. IHCs are physically located in a State, Nevada and Delaware are two popular examples, that does not impose income tax on revenue generated by intangible property. The IHC has no employees, property or bank accounts outside of the tax-haven State. The parent company transfers the intangible assets to the IHC, which enters into an agreement with the parent to permit

the use of the intangible property for retail or other purposes by the parent company or its related entities in various States. The parent or related company agrees to pay a royalty to the IHC, generally based on a percentage of the gross income earned by the related company through the use of the intangible assets, and deducts that royalty from the parent or related company's State income as a business expense. The IHC pays no tax on the royalty payments to its home tax-haven State, and resists attempts at taxation by the State in which the IHC's intangible property is used to generate revenue by arguing that the Commerce Clause precludes taxation because the IHC has no physical presence in the taxing State.

This scenario is precisely what transpired here. The parent company of Lane Bryant, a retailer of women's clothing, formed Lanco, a Delaware IHC. 52a. The parent transferred to Lanco the trademarks, service marks and good will associated with Lane Bryant stores, some of which are located in New Jersey. 53a. Lane Bryant and Lanco entered into an agreement through which Lane Bryant pays a monthly royalty in the form of a percentage of Lane Bryant's gross sales in New Jersey in exchange for the use of Lanco's intangible property. *Id.* Lane Bryant deducts the payments from its New Jersey income as a business expense, thereby significantly reducing its tax obligation to the State. Lanco pays no tax on the royalties to Delaware and takes the position that it may not be taxed by New Jersey because it has no physical presence in the State.

Although Lanco seeks to pay no tax to New Jersey on the income that it earns from the exploitation of the State's marketplace, Lanco derives numerous benefits from the use of its property in New Jersey. As the Tax Court of New Jersey found after hearing expert testimony, "Lanco clearly enjoys the same benefits provided to Lane Bryant" by New Jersey. 36a. In addition, among the expert testimony heard by the trial court was that "Lanco's licensure of intangibles for use in New Jersey imposes costs on the state because it generates economic activity that increases the demand for public services . . . ." 36a-37a. The expert opined that "Lanco benefits from this

activity, since it receives fees that increase with sales." 37a. Because Delaware does not tax income earned from the use of Lanco's intangibles, if petitioner prevails in its erroneous view of the Commerce Clause and escapes taxation by New Jersey, Lanco will pay no State income tax on its considerable earnings and a significant percentage of the income generated by retail sales in New Jersey will have been shielded from taxation by any State.

A. State Courts Are In Agreement In Holding That States May Impose Income Tax On Revenue Generated Through The Use of Intangible Property Where Taxpayers Attempt To Export That Revenue To A Tax-Haven State.

The Commerce Clause authorizes Congress to "regulate Commerce . . . among the several States . . . ." U.S. Const. art. 1, § 8, cl. 3. The dormant Commerce Clause is a "judicial creation" that presumes that the Clause "not only empowers Congress to regulate interstate commerce, but also imposes limitations on the States in the absence of congressional action . . . ." *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 401 (1994)(O'Connor, J., concurring). The essence of the Clause is that one State, in its dealings with other States, may "not place itself in a position of economic isolation . . . ." *City of Philadelphia v. New Jersey*, 437 U.S. 617, 623 (1978) (quotations omitted). Nor may a State enforce economic protectionism by penalizing interstate commerce for the benefit of similar intrastate economic activity. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996).

It has long been settled that in the area of State taxation a tax on interstate economic activity does not offend the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). It is the substantial nexus prong, and the question of whether an IHC

must be physically present in a State where its trademarks or other intangible property generate profits through retail sales by an affiliated or related corporation to satisfy the *Complete Auto Transit* test, that is presented by this petition.

The Supreme Court below, in deciding that question, reached the same result as every other court that has issued a published opinion on the subject: the physical presence test set forth by this Court in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), for establishing substantial nexus in the context of requiring a mail-order catalogue vendor to collect and remit sales and use tax does not apply outside of that limited area. This test, affirmed on the basis of *stare decisis* in *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992), has consistently been found not to apply to IHCs that attempt to shield from State taxation revenues generated by the use of their intangible property by related entities with a physical presence in the taxing State. Contrary to the arguments posited by petitioner, the State court decisions in this area are uniform and do not require clarification by this Court.

Shortly after issuance of the *Quill* decision, the South Carolina Supreme Court recognized the limited scope of the physical presence requirement applicable in the sales and use tax collection context. *Geoffrey, Inc. v. So. Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C.), *cert. denied*, 510 U.S. 992 (1993). There, the South Carolina Court upheld the application of that State's corporate income tax in circumstances strikingly similar to those before the New Jersey court below. Geoffrey was a Delaware holding corporation with no employees, officers, or tangible property in South Carolina. *Id.* at 15. The company owned several valuable trademarks and trade names, including "Toys 'R' Us," a trademark that matched the name of its parent corporation. *Id.* Through a licensing agreement with its related company, Geoffrey permitted the use of its trademarks by Toys "R" Us in South Carolina. Geoffrey received as consideration a percentage of the parent's net sales of merchandise in that State. *Id.* As is the case with Lanco, the effect of the corporate relationship between Geoffrey, Toys "R"

Us and their licensing agreement was the creation of "nowhere" income that escaped State taxation entirely. *Id.* at 15 n.1. In fact, in 1990, Geoffrey, without any full-time employees, had income of approximately $55 million and paid no State income tax at all. *Id.*

South Carolina ultimately made a determination that Geoffrey was subject to that State's corporate income tax. *Id.* at 15. Geoffrey claimed that the Commerce Clause allowed it to shield all of the profits that it made in South Carolina from State taxation because the company did not have a physical presence in that State. *Id.* at 16. Thus, the taxpayer in *Geoffrey* raised the identical argument Lanco makes in the case before this Court in an attempt to escape paying its fair share of tax to New Jersey.

The South Carolina Court, like the court below, found that the Commerce Clause was not offended by application of South Carolina's tax to the IHC. The Court found that reliance on the *Bellas Hess* physical-presence test by the taxpayer was "misplaced." *Id.* at 18. The court began its analysis by remarking that this Court in *Quill*, while reaffirming *Bellas Hess* for sales and use tax purposes, "noted that the physical presence requirement had not been extended to other types of taxes." *Id.* at 18 n.4. Recognizing legal precedents that permit the imposition of taxes other than sales and use tax in the absence of physical presence, the Court held "that by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina" for Commerce Clause purposes. *Id.* at 18.

Similarly, in *A & F Trademarks, Inc. v. Tolson*, 605 S.E. 2d 187 (N.C. Ct. App. 2004), *certif. denied*, 611 S.E.2d 168 (N.C.), *cert. denied*, 126 S. Ct. 353 (2005), the North Carolina Court of Appeals upheld the imposition of corporate taxes against corporations, including Lanco, the petitioner here, that had no physical presence in that State, but which licensed the use of their trademarks to North Carolina retailers. That court properly rejected the notion that *Quill* created an immutable

bright-line rule requiring physical presence before any corporate tax can be assessed against an entity conducting business in a State. *Id.* at 194. The *A & F* court adopted the themes that underlie the consistent line of precedent permitting the taxation of IHCs: (1) that significant differences exist between the sales and use taxes examined in *Quill* and the corporate business taxes assessed against IHCs, (2) that IHCs could not reasonably rely on a supposed bright-line rule requiring physical presence for the assessment of corporate taxes, and (3) that this Court begrudgingly affirmed the physical presence rule for sales and use taxes in *Quill* because of the powerful doctrine of *stare decisis*, but carefully limited its holding to the tax at issue in that case. *Id.* at 194-96. *See also Secretary, Dep't of Revenue v. Gap (Apparel), Inc.*, 886 So. 2d 459, 461-62 (La. Ct. App. 2004) (holding, without discussion of *Quill*, that Louisiana could impose a corporate income tax on a trademark holding company under facts almost identical to those presented here).

The intermediate appellate decision below, adopted by a *per curiam* decision of the Supreme Court of New Jersey, follows that rationale and the holdings in *Geoffrey* and *A & F*. *See* 20a ("We are satisfied that the physical presence requirement applicable to use and sales taxes is not applicable to income tax and the New Jersey Business Corporation Tax may be constitutionally applied to income derived by plaintiff from licensing fees attributable to New Jersey"). No published judicial opinion takes the opposite view. Under each existing precedent examining an IHC and its receipt of royalties from an affiliated corporation for use of the intangible assets, the facts of this case would have resulted in the same outcome: a holding that the Commerce Clause permits State taxation in these circumstances without the need to establish that the IHC had a physical presence in the taxing State. Simply put, there is no divergence of authority on the subject of this petition and no conflict for this Court to resolve.

State court decisions in other tax-related contexts have rejected the notion that the Commerce Clause requires a

physical presence for the imposition of an income tax. The Supreme Court of Appeals of West Virginia in *Tax Comm'r v. MBNA Am. Bank*, 640 S.E.2d 226 (W. Va. 2006), *petition for certiorari filed*, when examining a factual complex distinct from that presented by the IHC paradigm, held that the *Complete Auto Transit* substantial nexus prong does not require physical presence for the State to collect an income tax from a bank that earns money in West Virginia through its extension of credit to West Virginia consumers. This opinion, which rejected the argument that *Quill's* physical presence test applies beyond sales and use tax collection obligations, is consistent with the decision below and with each State court decision addressing State taxation of IHCs.[1]

In addition, courts have recognized that the Commerce Clause does not require a taxpayer's physical presence in a variety of other contexts. *See Borden Chemicals and Plastics, L.P. v.* Zehnder, 726 N.E.2d 73, 80 (Ill. App. Ct.)(holding application of personal property tax replacement income tax to an out-of-state corporation to be permissible because the "Quill court merely carved out a narrow exception in the area of use tax collection duties"), *app. denied*, 731 N.E.2d 762 (Ill. 2000); *Couchot v. State Lottery Comm'n*, 659 S.E.2d 1225, 1230 (Ohio)(holding that non-resident with no physical presence in State is subject to income tax on Ohio lottery winnings), *cert. denied*, 519 U.S. 810 (1996).

To support its suggestion of a conflict among the State courts, petitioner relies primarily on the holding of an

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[1]Petitioner pleads with this Court to hold this petition, should *certiorari* be granted in *MBNA*. Petition for Certiorari at 30. There is simply no reason for the Court take this approach. The unique circumstances presented by the IHCs and the overwhelming response of the States to eliminate the IHCs tax- avoidance scheme set this case apart from *MBNA*. Review is not warranted in this petition whether or not *certiorari* is granted in *MBNA*.

intermediate appellate court faced with facts significantly different from the IHC scenario. *J.C. Penney Nat'l Bank v. Johnson,* 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000). This decision reflects a wooden application of the *Quill* physical presence test with no meaningful analysis. *Id.* at 839 ("Any constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in *Bellas Hess* and *Quill* are not within the purview of this court to discern"). One decision of an intermediate appellate court, contrary to all other published opinions on the topic, does not constitute a conflict. Moreover, the continued validity of the *J.C. Penney* opinion has been called into doubt by subsequent judicial developments. *See e.g., America Online, Inc. v. Johnson,* 2002 WL 1751434 (Tenn. Ct. App. 2002)(rejecting a reading of *J.C. Penney* that "would simply substitute 'physical presence' for 'nexus.'"). Standing alone and undercut by subsequent precedent, the *J.C. Penney* holding is an insufficient basis for review by this Court.

Two other cases relied upon by petitioner, *Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349 (Mich. App. 1993), *app. denied sub nom*, 512 N.W.2d 846 (Mich. 1994), and *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000), also do not create a conflict. Neither of these intermediate appellate opinions applies the Commerce Clause to the IHC factual paradigm addressed below. *Rylander* rejected an attempt by Texas to tax an out-of-State corporation merely because it possessed a license to do business in that State. *Id.* at 299. The court held that possession of a license to do business, without further economic activity, did not satisfy the substantial nexus requirement of *Complete Auto Transit.* Given the exceedingly narrow basis upon which Texas attempted to impose its tax, the *Rylander* opinion creates no conflict with the decision below or the many precedents of this Court with which it is in accord. In *Guardian Corp.*, the court was faced with an unusual question – whether "sales" in other States were subject to tax in the other States and, therefore, eligible for exclusion from Michigan income. Although the

Guardian Corp. court held that *Quill* established a physical presence requirement for the imposition of all State taxes, the peculiar fact pattern before the *Guardian Corp.* court renders its decision of limited precedential value, and far afield from presenting a conflict with the decision below.

B. State Legislatures, In The Absence Of Congressional Action, Have Largely Eliminated The Tax Avoidance Potential Of Intangible Holding Companies Through Legislation, Greatly Reducing the Significance Of The Issue Addressed By The Lower Court And Militating Against Review By This Court.

As States have come to recognize the tax avoidance artifice of IHCs, legislative action has largely eliminated this tax shelter for income from intangible licensing agreements between related companies. These statutory developments reduce the significance of the issue raised by petitioner, provide further consistency in the treatment of taxpayers and militate against review by this Court.

When applying *stare decisis* in *Quill* to continue the physical presence requirement in the context of the sales and use tax collection obligation for out-of-State entities, this Court noted that the contours of Commerce Clause limitations on State taxation was an area ripe for legislative action. "Our decision is made easier by the fact that the underlying issue is not only one that Congress may be qualified to resolve, but also one that Congress has the ultimate power to resolve." 504 U.S. at 318. Congress has not acted, leaving the States to address the issue through legislative action.

In fact, the States' legislative activity has been consistent and widespread. In response to the decision of the trial court in this matter, New Jersey enacted legislation disallowing a deduction in Corporation Business Tax for royalty payments made to a related company for the use of intangibles. N.J. Stat. Ann. §54:10A-4.4(b); N.J. Admin. Code §18:7-5.18. Fourteen

other States have acted to preclude the tax sheltering benefit intended to be gained by the creation of IHCs. *See* Ala. Code §40-18-24, 40-18-35 (disallowing deductions for payments for use of intangibles to related entities); Ark. Code Ann. §26-51-423(g)(1)(limiting circumstances in which deduction is available for payments to related companies for the use of intangible property); Conn. Gen. Stat. §12-218c(b)(requiring add-back for payments made to related company for use of intangible property); D.C. Code Ann. §47-1803.03(a)(19) (disallowing deductions for payments associated with the use of intangibles of related companies); Ga. Code Ann. §48-7-28.3(b) (requiring add-back of royalty payments to related companies for the use of intangible property); Ind. Code §6-3-2-20(b)(requiring add-back of expenses associated with intangible property of related company); Ky. Rev. Stat. Ann. §141.205(2) and (4)(disallowing deduction for expenses paid to related company for use of intangible property); Md. Code Ann. Tax-Gen. §10-306.1(b)(2)(requiring add-back of payments to related companies for use of intangible property); Mass. Gen. Laws ch. 63, §31I (a) and (b)(requiring add-back of expenses to related companies associated with intangible property); Mississippi, Miss. Code Ann. §27-7-17(2)(b) (providing for add-back of expenses associated with intangibles from a related entity); N.Y. Tax Law §208(9)(o) (requiring add-back to income of royalty payments to a related company for the use of intangible property); N.C. Gen. Stat. §105-130.7A (where recipient and "payer" of expenses associated with intangible property are related, expenses must be added back to the income of "payer" or included in the income of recipient); Ohio Rev. Code Ann. §5733.042(C)(requiring add-back to income of expenses paid to related company for use of intangible property). *See also* Va. Code Ann. §58.1-446 (allowing for adjustments to reported income for improper exclusions) and *Ruling of Comm'r*, P.D. 05-29, Va. Dep't of Taxation (Mar. 2, 2005) and *Ruling of Comm'r*, P.D. 05-28, Va. Dep't of Taxation (Mar. 7, 2005)(exercising equitable authority of Commissioner to disallow deduction of expenses paid to related company for use of intangible property). In

these States, tax avoidance through the use of IHCs has been eliminated.

An additional twenty States use combined reporting for related corporate entities, eliminating the State tax avoidance benefits of IHCs because the deduction for royalty payments to IHCs will effectively be canceled by the concomitant income to the related entity. The States with combined reporting are: Alaska, Alaska Stat. §43.20.073(a); Arizona, Ariz. Rev. Stat. Ann. §43-947; California, Cal. Rev. & Tax. Code §23362; Colorado, Colo. Rev. Stat. §39-22-303(11); Hawaii, Haw. Rev. Stat. §18-235-22-03; Idaho, Idaho Code §63-3027(t); Illinois, 35 Ill. Comp. Stat. §5/502e; Kansas, Kan. Stat. Ann. §79-32,142(a); Maine, Me. Rev. Stat. Ann. §5220 and §5200.4; Minnesota, Minn. Stat. §289A.08.3; Montana, Mont. Code Ann. §15-31-141(1) and (2); Nebraska, Neb. Rev. Stat. §77-2734.01 and .05; New Hampshire, N.H. Rev. Stat. Ann. §77-A:6; North Dakota, N.D. Cent. Code §57-38-14; Oregon, Or. Rev. Stat. §317.710(2); Texas, Tex. Tax Code §171.1014 (eff. 1/1/08); Utah, Utah Code Ann. §59-7-402; Vermont, Vt. Stat. Ann §5862; West Virginia, W. Va. Code §11-24-13a(a). New York enacted combined reporting legislation on April 1, 2007, to begin with the 2007-2008 fiscal year. Michael Mazerov, Center on Budget and Policy Priorities, *Growing Number of States Considering a Key Corporate Tax Reform* (Apr. 5, 2007). Seven additional States (Iowa, Maryland, Massachusetts, Michigan, New Mexico, North Carolina, and Pennsylvania) are considering enacting combined reporting. Institute on Taxation and Economic Policy, *Combined Reporting: How Does Your State Stack Up?* (Apr. 2007).

As demonstrated above, a majority of State legislatures and taxing authorities, including in New Jersey where this appeal initiated, have sharply curtailed the value of IHCs as State tax avoidance mechanisms. Legislatures are engaged in addressing the issue raised in the petition, and the response has been an unwavering march toward State taxation of royalties paid between related companies for the use of intangible assets. This Court should refrain from entering a field that the other

branches of government are manifestly resolving in a uniform fashion.

II. The Decision Below Does Not Leave Matters In An Unprincipled Or Confused State Because The New Jersey Supreme Court's Decision Is Consistent With, And Reflective Of, The Commerce Clause Jurisprudence Of This Court.

In requesting *certiorari* review, petitioner clamors for a "default rule," suggesting that no bright line now exists with respect to the limits on State taxation under the Commerce Clause to guide lower courts or taxpayers in *Lanco*'s wake. The proverbial "parade of horribles" raised by petitioner does not exist, however, because as noted above, the *per curiam* decision by New Jersey's Supreme Court respects, in full, this Court's Commerce Clause jurisprudence and is wholly consistent with other States' highest courts.

Moreover, the decision below comports with this Court's Commerce Clause precedents on the larger question of the meaning of the substantial nexus prong of *Complete Auto Transit*. Petitioner's claim of uncertainty rests on the incorrect notion that this Court's prior rulings established a "bright line" requiring physical presence in the context of all State taxes, including corporate franchise or income taxes. The underpinning of petitioner's argument is flawed, however, because it reflects an overly narrow reading of *Quill*, *Bellas Hess* and the other cases upon which petitioner relies, as well as petitioner's failure to recognize crucial differences between the sales and use tax collection obligation at issue in those cases and the corporate income tax under scrutiny here.

A. This Court's Precedents Have Not Required A Single, Wooden Application Of The Commerce Clause To All Types Of State Taxes.

In *Quill*, this Court noted that the relevant nexus analysis is "informed not so much by concerns about fairness for the

individual defendant as by structural concerns about the effects of state regulation on the national economy." 504 U.S. at 312. Thus, the standard for application of the Commerce Clause to State taxes is a flexible one: State tax laws may not unduly burden interstate commerce. *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662 (1981); *City of Philadelphia, supra.* Indeed, the test as articulated by *Complete Auto Transit* requires a four-prong balancing which does not demand physical presence in all contexts, especially in light of the recent social, economic, commercial and legal innovations in interstate commerce.

The flexibility inherent in this Court's Commerce Clause analysis is reflected in the express delineation in *Quill* of the limited scope of the physical presence requirement: "we have not, in our review of other types of taxes, articulated the same physical presence requirement" as is required for the sales and use tax collection obligation. 504 U.S. at 314. The foregoing statement was not mere *dictum*, as petitioner suggests, but an express recognition by this Court that there exist distinctions among State taxes as well as the concomitant Commerce Clause nexus requirements for those impositions. *Id.* at 317.

In *Quill*, this Court recognized the insignificance of an entity's physical presence in a taxing State for Due Process purposes. In that context, the Court "abandoned more formalistic tests that focused on a defendant's 'presence' within a State in favor of a more flexible inquiry . . . ." *Quill*, 504 U.S. at 307. As this Court explained, "[i]n 'modern commercial life' it matters little that . . . solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State." *Id.* at 308.

The rationale for abandoning a physical presence requirement for Due Process Clause purposes recognizes that businesses engage in significant levels of commercial activity in a State without ever "setting foot" there. In this era of

"virtual offices," cellphones, BlackBerry devices and the Internet, rational enterprises can easily foresee being subject to State laws, including tax laws, as a result of their commercial activity directed to a particular State whether or not physically present in that State. Lest there be any confusion on this point, however, respondent does *not* suggest that the Due Process and Commerce Clause tests are identical, but in light of their similarities, given *Quill's* self-limiting application and *Complete Auto Transit's* four-part Commerce Clause test, there is plainly no principled reason why the Commerce Clause should require a corporation's physical presence to justify State taxation, especially when a State is able to establish that the corporation derives significant benefits from continued and deliberate economic activity in the taxing State, as New Jersey did through expert testimony adopted by the trial court below. 37a.

Indeed, while recognizing that over the last half of the Twentieth Century the Court has crafted a pragmatic approach to the Commerce Clause, the powerful influence of the doctrine of *stare decisis* ultimately swayed the *Quill* Court to follow its holding in *Bellas Hess* with respect to sales and use tax collection obligations. 504 U.S. at 309-11. The Court noted, however, that "[w]hile contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases." *Id.* at 311.

Having thus expressed its doubts about the continuing viability of the underlying wisdom of *Bellas Hess* as long as 15 years ago, the Court nonetheless declared that it would not abandon "the rule that *Bellas Hess* established *in the area of sales and use taxes.*" *Id.* at 317 (emphasis added). As New York's highest court describes the result: "the *Quill* decision cannot be substantively construed as other than a somewhat begrudging retention of the *Bellas Hess* physical presence requirement" for imposition of a sales tax collection obligation. *Orvis Co., Inc., v. Tax Appeals Tribunal*, 654 N.E.2d 954, 960 (N.Y.), *cert. denied sub nom*, 516 U.S. 989 (1995).

The decisive role of *stare decisis* in the continuation of the *Bellas Hess* standard in *Quill* cannot be overstated. The influence that the doctrine had on the holding in *Quill* is starkly revealed in the concurring opinion of Justices Scalia, Kennedy and Thomas, who would have adhered to *Bellas Hess* on grounds of *stare decisis* alone, 504 U.S. at 319-20, and in the partial dissent of Justice White, who thought that the physical presence rule was so anachronistic that he would have abandoned it in spite of *stare decisis*, *id.* at 322.

Petitioner is equally mistaken in its contention that the taxes at issue in *Quill* and in *Lanco* "are essentially indistinguishable" even in their economic effects. Petition for Certiorari at 19. Significant differences exist between the sales and use taxes found to require a physical presence for Commerce Clause purposes in *Bellas Hess* and *Quill* and the corporate franchise tax imposed in *Lanco*. The *Quill* Court expressed great concern about the then-6,000 local taxing jurisdictions throughout the United States which might impose varying rates, exemptions and reporting requirements for sales and use taxes on Quill. 504 U.S. at 313 n.6.

As this Court noted, sales and use taxes are generally due on a monthly basis. Today there exist approximately 7,500 distinct sales and use tax jurisdictions, many with different tax bases, different deductions and even different tax reporting forms. While the burden and cost of complying with such a vast array of sales and use tax requirements may still require a heightened presence requirement, petitioner is incorrect in its contention that "the complexity and burden of complying with corporate income and franchise taxes are greater than . . . [for] sales and use tax compliance." Petition for Certiorari at 20-21.

Corporate franchise taxes, like the Corporation Business Tax at issue in this case, are imposed on an annual basis. Corporate net income generally follows income computed for federal tax purposes. *See, e.g.*, N.J. Stat. Ann. 54:10A-4(d). Only forty-eight jurisdictions -- forty-six States, the District of Columbia, and the City of New York -- collect a corporate

franchise or income tax. Each such jurisdiction requires an annual return. *Congressional Research Service,* State Corporate Income Tax: A Description and Analysis (June 30, 2006) at CRS-2. Thirty-five States use the same measure of income as employed by the federal government. *Id.* at CRS-3. "The remaining states typically use a measure of income that closely follows the federal definition of taxable income. Using the federal starting point likely eases the compliance burden for corporations, particularly those that have nexus in several states." *Id.*

As one noted commentator put it:

> it may well be that the need for a "bright-line" rule in the context of income taxation is less compelling than in the context of sales and use taxation because the burdens of complying with the income tax laws of various state and local jurisdictions are less daunting than the burden of complying with the laws of the nation's 6,000-plus sales and use tax jurisdictions to which the Court alluded in *Quill.* [J. Hellerstein & W. Hellerstein, *State Taxation* Warren, Gorham & Lamont (3d ed. 1998) ¶6.30[5]].

Petitioner is thus plainly wrong when it contends that the court below, and the other State courts that reached the same result with respect to the taxation of IHCs, have unconstitutionally facilitated or created "relaxed nexus requirements" which "increase the burden on interstate commerce." Petition for Certiorari at 21. New Jersey sought only to tax income Lanco earned from New Jersey, on an apportioned basis. The realities of New Jersey - and other States' - corporate franchise or income taxes do not threaten to impose a meaningful administrative burden on the multistate corporations which reap significant economic benefits from the State markets they exploit.

B. New Jersey And Other States That Impose Income Or Franchise Taxes On IHCs Do Not Reach Beyond Their Borders And *Lanco* Follows This Court's Commerce Clause Analysis Which Is Manageable By The Judiciary And Taxpayers Alike.

Petitioner suggests that through *Lanco* and other similar cases, States have reached "outside [their] borders" to impose income or franchise taxes on IHCs. Petition for Certiorari at 23. The outer limit of petitioner's alarmist assertion is that there now exists no "judicially manageable default rule" applicable to State taxes. *Id.* at 22

Nothing could be further from the truth. First, as noted above, New Jersey's Appellate Division, in an opinion adopted by a *per curiam* decision of the Supreme Court, gave full effect to the flexible Commerce Clause nexus analysis enunciated by this Court in *Quill* and other precedents. In addition, as even petitioner concedes, the "modern economy may lack borders." *Id.* at 25. Indeed, the artifice of IHCs was created to capitalize on that very concept. And, as discussed above, the trial court in this case adopted expert testimony demonstrating that Lanco's exploitation of the New Jersey retail clothing sales market both burdened the State and benefitted Lanco in very concrete ways.

As a result, while it is true that one of the reasons that the *Quill* Court noted for abiding by *Bellas Hess* in the context of sales and use tax collection obligation was the idea that retaining the physical presence test would comport with "settled expectations and, in doing so, foster[] investment by businesses and individuals," 504 U.S. at 316, no such "settled expectations" exist with respect to other types of State taxes. This is so in part because of *Quill*'s express limitation to sales and use taxes. Moreover, the previously unfathomable technological changes of the last few decades have dictated that there are no "settled expectations" in business. The recent advent of entities such as IHCs, LLCs and other innovative

corporate formats confirms that "investment" is fostered in relation to the needs of the marketplace, not by the geopolitical boundaries of the various States.

Finally, petitioner suggests that principles of federalism provide a basis for *certiorari* in this case, asserting that "sovereignty over a specified geographical area and those who come within it" are somehow offended by Lanco. Petition for Certiorari at 26. This contention is erroneous because it suggests that New Jersey as well as any other States that tax IHCs are attempting to reach beyond their borders to tax multistate corporations. If federalism has any application to this petition at all, it supports the ability of the States to carry out their core governmental function of raising revenue through taxation. Petitioner's view of the law would undermine this important State function by imposing unnecessary limitations on State taxation.

State income and franchise taxes are judicially manageable under *Lanco* as well as the other State court decisions which have identically imposed tax on IHCs in accordance with this Court's Commerce Clause precedents. There is nothing "unprincipled" about asking corporations that reach into States for business and, presumably, profit, to pay their fair share of tax to those States on a constitutionally-approved apportioned basis.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be denied.

Respectfully submitted,

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